

Message Text

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FM SECSTATE WASHDC

TO ALL OECD CAPITALS

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FOLLOWING TEL SENT ACTION SECSTATE, EC BRUSSELS, GENEVA FROM
TOKYO APRIL 28:

QUOTE LIMITED OFFICIAL USE TOKYO 6325

PASS ALL OECD CAPITALS, TREASURY, AND CEA

EA FOR ASST SECY HOLBROOKE

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TAGS: EGEN, JA

SUBJECT: EXPANDING THE JAPANESE ECONOMY -- MUCH EFFORT,
SOME RESULTS

1. SUMMARY. AS THE LONDON SUMMIT APPROACHES, JAPANESE
ECONOMIC GROWTH CONTINUES TO DISPLAY A MIXED PATTERN, WITH
SOME CONTINUING WEAKNESS IN DOMESTIC DEMAND. DURING APRIL
THE JAPANESE AUTHORITIES HAVE OFFERED THE ECONOMY ADDITIONAL
DOSES OF STIMULI ALREADY APPLIED EARLIER; THE NEW MEASURES
INCLUDED A LARGE AND POLITICALLY DIFFICULT DISCOUNT RATE CUT
ANNOUNCED JUST AFTER MID-MONTH.

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2. THE SEASONALLY ADJUSTED MARCH FIGURES FOR INDUSTRIAL
SHIPMENTS, WHICH ROSE SHARPLY, AND FOR INDUSTRIAL PRODUCTION,
WHICH ALSO REBOUNDED, ARE ENCOURAGING. EXPORTS, TOO, DISPLAYED
EMBARRASSING STRENGTH THROUGH THE FIRST QUARTER OF 1977.
BUT DOMESTIC CONSUMPTION STILL SHOWS LITTLE VIGOR, AND IT
IS UNLIKELY TO STRENGTHEN SIGNIFICANTLY UNTIL MORE
PROGRESS IS MADE IN REDUCING THE RATE OF INFLATION. THE
INVESTMENT SLUMP ALSO CONTINUES. THERE ARE, HOWEVER, SOME
GROUNDS FOR HOPE THAT WITH THE DISCOUNT RATE CUT OUT OF
THE WAY, PENT-UP DEMAND MAY PROVIDE AT LEAST A SMALL

BOOST TO CAPITAL SPENDING. INFLATION REMAINS A CONCERN. CONSUMER PRICES CONTINUE TO RISE AT ALMOST 10 PERCENT PER ANNUM, ALTHOUGH WHOLESALE PRICE INCREASES HAVE REMAINED VERY MODERATE IN RECENT MONTHS. IT IS MOST UNLIKELY THAT MAJOR ADDITIONAL EXPANSIONARY MEASURES WILL BE FOUND PRACTICABLE IN THE NEAR FUTURE.

3. THE CURRENT IRREGULAR GROWTH PATTERN MAKES IT PARTICULARLY DIFFICULT TO PREDICT WHETHER JAPAN'S 6.7 PERCENT GROWTH TARGET FOR FISCAL 1977 WILL BE REACHED. THE GOVERNMENT, WITH AN EYE TO THE ELECTIONS IN JULY, HAS PUT A LOT OF ITS MONEY ON OBTAINING A STRONG RECOVERY IN THE APRIL-JUNE QUARTER, AND IF THE TRADITIONAL TOOLS STILL WORK, THE GAMBLE SHOULD SUCCEED. BUT THE SECOND HALF OF THE FISCAL YEAR COULD PRESENT A LESS SATISFACTORY PICTURE, UNLESS THE INVESTMENT CLIMATE IMPROVES CONSIDERABLY MORE THAN CAN BE FORESEEN AT PRESENT. END SUMMARY.

4. AS THE SUMMIT MEETING IN LONDON DRAWS NEAR, JAPAN APPEARS TO BE MEETING WITH MIXED SUCCESS IN HER CONTINUING EFFORTS TO RESUME AT A 6.7 PERCENT LEVEL THE PATH OF STABLE AND BALANCED BROWTH. INDUSTRIAL PRODUCTION ROSE STRONGLY IN MARCH AND SHIPMENTS GAINED FOR THE THIRD CONSECUTIVE MONTH. EXPORTS ALSO ROSE SHARPLY AFTER A SEASONALLY ADJUSTED DECLINE IN FEBRUARY, BUT DOMESTIC LIMITED OFFICIAL USE
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CONSUMER DEMAND REMAINS INDIFFERENT. INVESTMENT APPEARS TO REMAIN WEAK.

5. INDUSTRIAL PRODUCTION AND SHIPMENTS OF INDUSTRIAL GOODS BOTH SHOWED SUBSTANTIAL GAINS IN MARCH. PRODUCTION ROSE 0.9 PERCENT AND SHIPMENTS ROSE 1.8 PERCENT, SEASONALLY ADJUSTED.

6. OTHER MARCH INDICATORS SUGGEST THAT DOMESTIC CONSUMER DEMAND, IN NOMINAL TERMS, MAY NOT BE INCREASING QUITE FAST ENOUGH TO KEEP UP WITH PRICE INFLATION. PRELIMINARY TOKYO DEPARTMENT STORE SALES FIGURES FOR MARCH ROSE 6 PERCENT OVER THOSE POSTED A YEAR EARLIER. MARCH 1977 SALES OF SMALL BUSINESS ENTERPRISES NATIONWIDE ARE ESTIMATED TO HAVE RISEN 6.9 PERCENT OVER MARCH 1976. FIGURES FOR THESE AREAS OF CONSUMPTION FALL SOMEWHAT SHORT OF THE RECENTLY ESTIMATED 9.3 PERCENT RISE IN THE TOKYO CONSUMER PRICE INDEX FROM MARCH 1976 TO MARCH 1977.

7. SOME INFERENCES AS TO FUTURE CONSUMPTION TRENDS CAN BE DRAWN FROM THE FACT THAT ANNUAL WAGE INCREASES THIS SPRING ARE RANGING BETWEEN 8 PERCENT AND 9 PERCENT FOR

GENERALLY TROUBLED INDUSTRIES LIKE STEEL AND BETWEEN 9 PERCENT AND 10 PERCENT FOR MORE PROSPEROUS ONES LIKE AUTOS. THESE INCREASES WOULD IMPLY GROWTH IN NOMINAL CONSUMPTION EXPENDITURES ROUGHLY CORRESPONDING TO THE CURRENT RATE OF INCREASE IN THE CONSUMER PRICE INDEX. SUBSTANTIAL GROWTH IN REAL AS OPPOSED TO NOMINAL CONSUMPTION SEEMS LIKELY TO DEPEND HEAVILY ON JAPAN'S SUCCESS IN DECELERATING HER INFLATION.

8. A SEASONALLY ADJUSTED GAIN OF 3.6 PERCENT IN EXPORTS DURING MARCH, PRODUCING A TOTAL FIGURE 20.2 PERCENT ABOVE THAT IN MARCH 1976, UNDERSCORES THE CONTINUING STRENGTH OF FOREIGN DEMAND FOR JAPANESE LIMITED OFFICIAL USE
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PRODUCTS. THE SIZE OF JAPAN'S CURRENT ACCOUNT SURPLUS (\$795 MILLION, SEASONALLY ADJUSTED, IN MARCH) CONTINUES TO EMBARRASS JAPANESE OFFICIALS.

9. PRIVATE INVESTMENT REMAINS THE WEAKEST LINK IN THE JAPANESE EFFORT TO STRENGTHEN DEMAND. THE SERIES OF STIMULATIVE MEASURES UNDERTAKEN SINCE NOVEMBER 1976 BY THE JAPANESE GOVERNMENT APPARENTLY HAS NOT YET OVERCOME BUSINESS HESITANCY TO ORDER NEW PRODUCTION FACILITIES. RECENT INDUSTRIAL CAPITAL SPENDING FORECASTS REMAIN GENERALLY FLAT. LOWEST OF THESE IS A NO-GROWTH PREDICTION BY THE BANK OF JAPAN FOR FISCAL YEAR 1977 (APRIL 1977 TO MARCH 1978) OVER FY 1976, AND HIGHEST IS A 2.1 PERCENT INCREASE FOR THE SAME PERIOD PREDICTED BY THE SEMI-GOVERNMENTAL JAPAN DEVELOPMENT BANK. THESE FIGURES ARE PARTICULARLY NOTEWORTHY BECAUSE THE PROJECTED INCREASE OF 6.7 PERCENT IN JAPAN'S REAL GROSS NATIONAL PRODUCT FOR FISCAL 1977 ASSUMES A 12.2 PERCENT NOMINAL INCREASE IN INDUSTRIAL INVESTMENT. MEANWHILE, MACHINERY ORDERS WITH THEIR IMPLICATIONS FOR FUTURE CAPITAL SPENDING FELL 17 PERCENT IN FEBRUARY AFTER TWO CONSECUTIVE MONTHLY GAINS, WITH SETBACKS IN THE ELECTRIC POWER AND MANUFACTURING SECTORS.

10. HOW TO GET INVESTMENT MOVING AGAIN? IN MID-APRIL JAPANESE OFFICIALS DECIDED TO PROVIDE ADDITIONAL DOSES OF REMEDIES ALREADY APPLIED EARLIER IN THE RECOVERY PAUSE. ON APRIL 18 THE BANK OF JAPAN (BOJ) ANNOUNCED A DECREASE IN ITS DISCOUNT RATE FROM 6 PERCENT TO 5 PERCENT, FOLLOWING A 0.5 PERCENT REDUCTION IN MARCH. JAPANESE FINANCIAL INSTITUTIONS NOW ARE IN THE PROCESS OF MAKING CUTS IN A BROAD RANGE OF LENDING AND DEPOSIT RATES.

11. THESE INTEREST RATE CUTS WILL LOWER THE COST OF CAPITAL IN JAPAN MUCH MORE THAN WOULD BE THE CASE IN EUROPE OR NORTH AMERICA BECAUSE IN JAPAN THE RATIO OF

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DEBT TO EQUITY FINANCING IS EXTRAORDINARILY HIGH. THE RATE CUT THUS WILL PROVIDE A STRONG BOOST FOR JAPANESE BUSINESS PSYCHOLOGY. IN ADDITION, THE NEXT MONTHS MAY WITNESS THE RELEASE OF SOME DEMAND FOR FUNDS HITHERTO PENT UP IN EXPECTATION OF THE RATE CUT. THE EXTENT AND EFFECT OF SUCH NEWLY LIBERATED DEMAND IS, HOWEVER, DIFFICULT TO ESTIMATE.

12. THE CUT WAS TAKEN IN SPITE OF A SERIOUS POLITICAL DRAWBACK. SAVINGS ACCOUNT INTEREST RATES IN THIS NATION OF SAVERS WILL NOW HAVE TO BE REDUCED, LESS THAN THREE MONTHS BEFORE THE HOUSE OF COUNCILLORS' ELECTION EXPECTED IN JULY.

13. THE DISCOUNT RATE CUT, BY PREPARING THE WAY FOR A LOWER RETURN ON YEN-BASED FINANCIAL INSTRUMENTS, HAS HELPED MAKE THE YEN LESS ATTRACTIVE AFTER AN EARLIER STEADY RISE RELATIVE TO THE DOLLAR SINCE THE BEGINNING OF 1977. FROM A PEAK OF ABOUT 271 YEN TO THE DOLLAR EARLY IN THE WEEK BEFORE THE RATE CUT, THE YEN EASED TO 278.40 YEN TO THE DOLLAR ON APRIL 28.

14. IN A STIMULATORY MOVE WHICH COMPLEMENTS THE DISCOUNT RATE CUT, THE JAPANESE GOVERNMENT ORDERED AN ACCELERATION IN PUBLIC WORKS SPENDING FOR THE THIRD TIME SINCE NOVEMBER. IT WAS ANNOUNCED APRIL 19 THAT CONTRACTS ARE TO BE LET BY JUNE 30 FOR SLIGHTLY MORE THAN HALF THE JAPANESE FISCAL YEAR 1977 (APRIL 1977 TO MARCH 1978) PUBLIC WORKS BUDGET. THIS ACTION WILL FURTHER RAISE THE HIGH CONCENTRATION OF PUBLIC SPENDING ALREADY PLANNED FOR THE CURRENT QUARTER.

15. REPORTS OF BUSINESSMEN AND CONSUMERS' REACTION TO THE DISCOUNT RATE FROP HAVE VARIED FROM PESSIMISM AS TO ITS PROSPECTS FOR STIMULATING THE ECONOMY, THROUGH OPTIMISM OVER ITS PROBABLE IMPACT, TO FEARS THAT AN
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INFLATIONARY SPIRAL MAY RESULT. THESE FEARS MAY WELL DRAW STRENGTH FROM THE CONSUMER PRICE INDEX INCREASE OF 9.4 PERCENT FOR ALL JAPAN BETWEEN MARCH 1976 AND MARCH 1977. WHOLESALE PRICES, RISING DURING THE FIRST QUARTER OF 1977 AT AN ANNUAL RATE OF ONLY 1.6 PERCENT, REFLECTED THE RECENT MONTHS OF RELATIVELY SLOW ECONOMIC ACTIVITY.

16. JAPAN PROBABLY WILL PAUSE FOR THE NEXT FEW MONTHS

IN HER ATTEMPTS TO SPEED HER GROWTH RATE WITH THE INSTRUMENTS OF MONETARY POLICY. THE MARCH INDUSTRIAL PRODUCTION FIGURES, TOGETHER WITH INDUSTRIAL SHIPMENT GAINS DURING SEVERAL RECENT MONTHS, MAY INDICATE A RESUMPTION OF A SATISFACTORY TOTAL GROWTH RATE, ALTHOUGH THE OUTLOOK FOR INVESTMENT REMAINS UNFAVORABLE. IN ANY CASE THE DISCOUNT RATE CUT WILL REQUIRE ADJUSTMENTS IN INTEREST RATE STRUCTURES THROUGHOUT THE BANKING SYSTEM, AND THE FULL EFFECT OF THESE CHANGES ON ECONOMIC ACTIVITY IS NOT LIKELY TO BE APPARENT IMMEDIATELY.

17. A FURTHER FISCAL STIMULUS COULD TAKE THE FORM OF A SUPPLEMENTAL BUDGET, BUT AT THE MOMENT IT APPEARS UNLIKELY THAT ANY SUBSTANTIAL ADDITIONAL GOVERNMENT SPENDING WILL BE CONSIDERED UNTIL SOME TIME HAS PASSED TO ENABLE THE JAPANESE AUTHORITIES TO ASSESS THE RESULTS OF OFFICIAL ACTIONS ALREADY TAKEN.

18. GIVEN THE CONSTRAINTS WITHIN WHICH JAPAN OPERATES AND THE CURRENT MIXED TRENDS IN HER ECONOMY, WE CANNOT CONFIDENTLY PREDICT WHETHER THE EXPANSIONARY MEASURES SHE ALREADY HAS TAKEN, AND THOSE SHE MAY LATER BE IN A POSITION TO TAKE, WILL ENABLE HER TO MEET HER OFFICIAL GROWTH TARGETS. AT THIS JUNCTURE, HOWEVER, IT APPEARS THAT HER ACTIONS TO DATE REPRESENT A SERIOUS EFFORT TO DO SO. SHOESMITH UNQUOTE VANCE

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